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January 4, 2017

VIA ECF AND HAND DELIVERY

The Honorable Alvin K. Hellerstein
United States District Judge
Southern District of New York
Daniel Patrick Moynihan United States Courthouse
500 Pearl Street
New York, NY 10007-1312

Re: *In re American Realty Capital Properties, Inc. Litigation* (1:15-mc-00040-AKH) (the "Class Action")

Dear Judge Hellerstein:

The Court has scheduled a status conference for January 10, 2017 to discuss, among other things, class certification proceedings for the Class Action. In accordance with the Court's discussion and instructions at the September 8, 2016 conference and its September 8, 2016 scheduling order, Defendants submit this letter highlighting certain issues that Defendants anticipate will be raised at the class certification stage. *See* Scheduling Order, ECF No. 299, at 2 (scheduling status conference for January 10, 2017 "to discuss class action certification proceedings . . . with a joint-letter suggesting an agenda and issues to be decided to b[e] submitted by January 4, 2017"); Transcript, ECF No. 304, at 15:8-19:10 (same).[1]

[1] On December 31, 2016, Defendants circulated to Plaintiffs a draft of the joint letter requested by the Court, requesting that Plaintiffs supply their positions on these issues. Plaintiffs stated that they would not do so because they did not think it was responsive to the Court's request.

Before the Court may certify a class, Plaintiffs must "affirmatively demonstrate" that they satisfy the requirements of Rule 23(a), and at least one of the provisions of Rule 23(b). *Comcast Corp. v. Behrend*, 133 S. Ct. 1426, 1432 (2013). "Rule 23 does not set forth a mere pleading standard." *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 350 (2011). Rather, a plaintiff must "***prove*** that there are *in fact* sufficiently numerous parties, common questions of law or fact, etc." *Id.* (first emphasis added). This requires the Court to perform a "rigorous analysis" of Rule 23's requirements, *id.* at 350-51, which "will frequently entail overlap with the merits of the plaintiff's underlying claim." *Comcast*, 133 S. Ct. at 1432.

1. Predominance Issues

Plaintiffs seeking to certify a class pursuant to Rule 23(b)(3) must demonstrate predominance, *i.e.*, that "questions of law or fact common to class members predominate over any questions affecting only individual members[.]" *Glatt v. Fox Searchlight Pictures, Inc.*, 811 F.3d 528, 538 (2d Cir. 2016). In an attempt to satisfy Rule 23(b)(3)'s predominance requirement, Plaintiffs have invoked the rebuttable fraud-on-the-market presumption to prove the reliance element of each putative class member's claim under Section 10(b) of the Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. Third Am. Class Action Compl., ¶¶ 285-86.[2] As the Supreme Court recently explained, Plaintiffs must "***prov[e]*** the prerequisites for invoking the presumption—namely, publicity, materiality, market efficiency, and market timing. The burden of proving those prerequisites still rests with plaintiffs and (with the exception of materiality) must be satisfied ***before*** class certification." *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2412 (2014) (emphasis added). Based on their preliminary analysis,[3] Defendants believe that Plaintiffs will be unable to establish reliance using the fraud-on-the-market presumption for at least two independent reasons: (1) Plaintiffs will not be entitled to the presumption because they will be unable to prove market efficiency for all securities for the duration of the proposed class period, and (2) if Plaintiffs demonstrate entitlement to the presumption, Defendants will be able to rebut it at the class certification stage by proving that the alleged misrepresentations had no price impact. These issues are likely to be the subject of expert testimony, requiring significant expert discovery.

<u>Plaintiffs Will Be Unable to Prove Market Efficiency</u>: Plaintiffs seek to certify a class of investors in at least nine different securities over a three-year period. To succeed, Plaintiffs must prove that the market for ***each of these securities*** was efficient throughout

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[2] Without this "presumption of reliance, a Rule 10b–5 suit cannot proceed as a class action: Each plaintiff would have to prove reliance individually, so common issues would not 'predominate' over individual ones, as required by Rule 23(b)(3)." *Halliburton*, 134 S. Ct. at 2416.

[3] Arguments raised by Defendants in opposition to class certification may depend on the arguments, expert testimony, and other evidence presented by Plaintiffs in connection with their motion for class certification. Accordingly, this letter describes certain issues that are likely to arise in connection with class certification proceedings. Defendants reserve the right to make additional arguments in opposition to class certification.

the entire portion of the class period in which the security was traded. *See Halliburton*, 134 S. Ct. at 2412 (noting proof of market efficiency as a prerequisite to application of the fraud-on-the-market presumption); *In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1, 3–4, 4 n.7, 19 (1st Cir. 2005) (vacating district court order certifying a class for portion of proposed class period because court failed to conduct proper analysis of market efficiency factors); *In re Winstar Commc'ns Sec. Litig.*, 290 F.R.D. 437, 447 (S.D.N.Y. 2013) (certifying a class for debt securities issued in private placement only for the time period after those securities were publicly registered because during the "private placement period" they did not trade in an efficient market).

Based on their preliminary analysis, Defendants do not believe that Plaintiffs will be able to carry this burden. Indeed, many of the factors courts use in examining market efficiency, such as the number of analysts covering a security and the percentage of that security held by institutional investors, do not support a finding of market efficiency. For example, for nearly half of the putative class period there were only two or fewer analysts covering ARCP, and less than 10% of ARCP's common stock was held by institutional investors, both of which are indicia that the market for ARCP's securities was not efficient. *See e.g.*, *Krogman v. Sterritt*, 202 F.R.D. 467, 475 (N.D. Tex. 2001) (existence of only two analysts did not support an inference of market efficiency).[4] Additionally, certain of ARCP's other securities at issue were restricted during a critical part of the class period and could be traded only among certain qualified buyers.

<u>Defendants Will Rebut the Fraud-on-the-Market Presumption</u>: Even assuming, *arguendo*, that Plaintiffs could establish a factual basis for the existence of an efficient market, the fraud-on-the-market presumption of reliance is rebuttable at the class certification stage. As the Supreme Court has held, if the "alleged misrepresentation *had no price impact* . . . the fraud-on-the-market theory does not apply and common reliance thus cannot be presumed." *Halliburton*, 134 S. Ct. at 2415 (emphasis added). "Price impact is thus an essential precondition for any Rule 10b–5 class action," *id.* at 2416, and "Defendants may seek to defeat the *Basic* presumption at [the class certification] stage through direct as well as indirect price impact evidence." *Id.* at 2417. Based on their preliminary analysis, Defendants believe they can rebut the fraud-on-the-market presumption in this case through proof of lack of price impact.

Indeed, Plaintiffs devote much of their Third Amended Complaint to supposed claims based upon alleged misstatements or omissions that ***had no price impact*** on any of ARCP's securities. For example, although ARCP's stock price fell in response to limited

[4] "[T]he mere fact that a stock trades on a national exchange does not necessarily indicate that the market for that particular security is efficient." *Bell v. Ascendant Sols., Inc.*, 422 F.3d 307, 313 (5th Cir. 2005); *see also In re Fed. Home Loan Mortg. Corp. (Freddie Mac) Sec. Litig.*, 281 F.R.D. 174, 175 (S.D.N.Y. 2012) (market for preferred shares listed on national market found to be inefficient); *Cammer v. Bloom*, 711 F. Supp. 1264, 1281 (D.N.J. 1989) ("It would be illogical to apply a presumption of reliance merely because a security is traded within a certain 'whole market', without considering the trading characteristics of the individual stock itself.").

disclosures made by ARCP on October 29, 2014, most of Plaintiffs' fraud claims are premised on disclosures made on March 2, 2015, following which there was no adverse price reaction. To the contrary, ARCP's stock price increased after the March 2015 disclosures. Moreover, Defendants anticipate that discovery will show that the alleged misstatements purportedly corrected in March 2015 had no positive, statistically significant price impact on ARCP's securities at the time they were made. Without price impact, the fraud-on-the-market theory does not apply, and Plaintiffs cannot certify a class. *Halliburton*, 134 S. Ct. at 2416 ("While [the fraud-on-the-market presumption] allows plaintiffs to establish [price impact] indirectly, it does not require courts to ignore a defendant's direct, more salient evidence showing that the alleged misrepresentation did not actually affect the stock's market price and, consequently, that the *Basic* presumption does not apply.").[5] For this reason, Plaintiffs will not be able to certify a class of investors who allegedly relied on misstatements that were disclosed on March 2, 2015—a significant portion of the putative class.

2. Other Rule 23 Issues

Defendants also intend to take discovery regarding whether the putative class representatives can satisfy Rule 23(a)'s requirements, such as typicality and adequacy. To the extent that Plaintiffs are subject to unique defenses not applicable to the class as a whole, class certification is inappropriate. *See Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 903 F.2d 176, 180 (2d Cir. 1990). Many of the named Plaintiffs are sophisticated institutional investors that may not have relied upon the market price of ARCP's securities when making purchases, may have known or believed the market to be inefficient, or may have had access to information which precludes reliance on the alleged misstatements. *See, e.g.*, *Blank v. Jacobs*, 2009 WL 3233037, at *5 (E.D.N.Y. Sept. 30, 2009) (citing cases and discussing how the timing of alleged purchases, and questions of reliance on relevant statements, may defeat typicality). Similarly, certain Plaintiffs may not be able to "trace" their shares, as required for their claims under Section 11 of the Securities Act of 1933, rendering them atypical. *DeMaria v. Andersen*, 318 F.3d 170, 178 (2d Cir. 2003). These unique defenses would preclude those Plaintiffs from acting as class representatives.

Finally, Defendants intend to take fact discovery of Plaintiffs to determine whether there are conflicts of interest between Plaintiffs and members of the putative class.

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[5] Relatedly, Plaintiffs must also come forward at the class certification stage with a damages model that identifies and excludes "damages that are not the result of the wrong" being alleged. *Comcast*, 133 S. Ct. at 1434; *Roach v. T.L. Cannon Corp.*, 778 F.3d 401, 407 (2d Cir. 2015) ("a model for determining classwide damages relied upon to certify a class under Rule 23(b)(3) must actually measure damages ***that result from the class's asserted theory of injury***") (emphasis added). For example, where alleged misstatements and corrective disclosures were accompanied by other ARCP-specific news, unrelated to Plaintiffs' "theory of injury," Plaintiffs' damages model must exclude any impact those other pieces of information may have had on the price of ARCP securities and any corresponding alleged damages to Plaintiffs. Defendants anticipate that this, too, will be the subject of expert testimony.

Based on the documents produced by Plaintiffs to date, it is clear that certain of the named Plaintiffs made purchases of ARCP stock after the October 2014 disclosure (including on the disclosure date), suggesting a potential conflict of interest between those named Plaintiffs and the absent class members. *See, e.g.*, *In re Enron Corp. Sec. Litig.*, 206 F.R.D. 427, 455 (S.D. Tex. 2002) (identifying conflicts between pre- and post-disclosure purchasers). Further discovery is required to determine the extent of such post-October 2014 trading.

Defendants thank the Court for its attention to this matter.

Respectfully submitted,

Antonia M. Apps

cc: All counsel (*via ECF*)